No. 20390

In the

United States Court of Appeals

for the Ninth Circuit

A. Bates Butler, as Trustee of Construction Materials Co.,
Appellant,

vs.

City of Tucson, et al.,
Appellees.

Martin Construction Co. and Pacific National Insurance Co.,
Appellants,

vs.

Bank of Tucson, et al.,
Appellees.

On Appeal from the United States District Court
for the District of Arizona

Answering Brief of Appellees Pacific National Insurance Company and Martin Construction Company

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Opening Brief on Cross-Appeal

Chandler, Tullar, Udall & Richmond
304 Southern Arizona Bank Building
Tucson, Arizona 85701

Attorneys for Appellees and Cross-Appellants Pacific National Insurance Company and Martin Construction Company

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PREFATORY NOTE

Throughout this brief and the following brief on cross-appeal, appellant A. Bates Butler, trustee in bankruptcy of Construction Materials Co., bankrupt, is referred to as "Trustee;" Construction Materials Company as "Construction;" City of Tucson as "City;" The Bank of Tucson as "Bank;" Martin Construction Company as "Martin," and Pacific National Insurance Company as "Pacific."

Most of the ultimate facts in the trial court were undis-

puted, and were made part of the record by a written Stipulation of Facts filed December 7, 1964, which stipulation is listed as document No. 28 in the Clerk's Certificate to Record on Appeal. This document is cited hereinafter as "Stipulation."

JURISDICTIONAL STATEMENT

Trustee invoked the jurisdiction of the United States District Court for the District of Arizona under the provisions of Title 11 USC Chapter 7, Section 110 and amendments thereto, Section 70 of the Bankruptcy Act (Count III, Complaint). Jurisdiction of this court on appeal is asserted under Title 11 USC Chapter 4, Section 47.

STATEMENT OF THE CASE

Trustee under Counts I and II of his Complaint sought to set aside transfers by City to Bank under two improvement district contracts, and by Count III to obtain possession of certain improvement district bonds to be issued by City under one of said contracts. Count I dealt with the El Campo Estates Improvement District Contract (Joint Exhibit 1) and Counts II and III with the Wilmot Improvement District Contract (Joint Exhibit 18). Trustee in his Opening Brief abandoned his appeal as to Counts I and II of the Complaint, thereby limiting his appeal to his claim to the improvement district bonds under the Wilmot contract. Trustee's statement of the facts of the case, however, is directed in part to the El Campo district contract and an assignment of proceeds thereunder, which are no longer germane to this appeal. It becomes necessary, therefore, to supplement Trustee's statement with certain facts pertinent to the Wilmot Improvement District Contract.

On or about March 26, 1963, Construction and City entered into the Wilmot Improvement District Contract; on the same date, Pacific as surety executed a labor and material bond and performance bond which were incorporated in said contract. By letter agreement (Joint Exhibit 32) dated May 8, 1963, Martin agreed to furnish all materials, labor and equipment necessary to complete certain portions of the said contract, and Construction agreed to assign approximately $68,754.42 of the bonds on the project to Martin. It was stipulated at trial by all parties except Trustee, who disavowed any interest in Martin's claim, that Richard L. Martin, president of Martin, would testify that Martin performed the work under Joint Exhibit 32 and remained unpaid (Transcript of Proceedings, pp. 111-112).

Martin's claim upon the City for bonds to be issued in connection with the contract in the sum of $68,754.42 (Joint Exhibit 21) was acknowledged by memorandum (Joint Exhibit 22) circulated on or about September 6, 1963, by the director of finances and administration of City (Stipulation).

Bonds in the total sum of $57,383.64 were duly issued by City and on November 20, 1964 delivered to the Clerk of the United States District Court (Stipulation).

The trial court concluded that Martin had an equitable lien against the said bonds, subject and inferior to the right of Bank under an assignment by Construction on or about April 2, 1963, but superior to Trustee's claim. (The respective rights of Martin and Bank are the subject of the Opening Brief on Cross-Appeal, *infra*.)

ARGUMENT

Construction's agreement in writing on May 8, 1963, to assign to Martin certain improvement district bonds cre-

ated an equitable lien upon said bonds which was perfected no later than September 6, 1963, when City received notice of the claim.

While a mere agreement to assign a debt or chose in action at some future time will not operate as an assignment thereof so as to vest any present interest in the assignee, in equity under certain circumstances an agreement to assign or an agreement to pay a debt out of a certain fund may operate as a valid assignment; 6 CJS 1092, Assignments Section 43.

An equitable assignment is such an assignment as gives the assignee a title which, although not cognizable at law, equity will recognize and protect. It is in the nature of a declaration of trust, and is based on principles of natural justice and essential fairness, without regard to form; 6 CJS 1045, Assignments Section 1(b).

An assignment which a court of equity will recognize and which a court of law will not constitutes an equitable assignment, it being implied from the circumstances and because of the equities involved, and recognized solely because the assignee is a purchaser for value. No particular form is necessary to constitute an equitable assignment, and any words or transactions which show an intention on the one side to assign and an intention on the other to receive, if there is a valuable consideration, will operate as an effective equitable assignment; 6 CJS 1101, Assignments Section 58, *et sequitur*.

Where the transaction is evidenced by a written agreement, it depends on the intention of the parties as manifested in the writing construed in the light of such extrinsic circumstances as, under the general rules of law, are admissible in aid of the interpretation of written instruments. *Ibid*, page 1102.

To work an equitable assignment there must also be an actual or constructive appropriation of the subject matter. *Ibid*, page 1102.

The test is whether the debtor, here the City, would be justified in paying the debt to the person claiming to be the assignee. *Ibid*, page 1107, n. 53.

The foregoing rules are enunciated in Arizona case law, including those cases cited in Trustee's opening brief. The language from *Stephen v. Patterson* (1920), 21 Ariz. 308, 311, 188 Pac. 131, 132, quoted on page 5 of Trustee's brief, seems applicable to the present case. On the other hand, the quotation from *Moeur v. Farm Builders Corp.* (1929), 35 Ariz. 130, 138, 274 Pac. 1043, 1045, appearing on the same page, is inappropriate to the present case. The statement in the *Moeur* case that a promise to pay out of a particular fund does not give to the promisee an equitable assignment or lien upon such fund, or the property from which the fund is obtained, has no application where "Contruction Materials Company agreed to assign approximately $68,754.42 of the bonds on this project to the Martin Construction Company" (Joint Exhibit 32). Where there is a promise to pay a portion of a fund (rather than to pay out of a fund), or to assign property to be obtained by the promisor (rather than to pay out of the proceeds of such property), a lien arises under the familiar rule of equity that a contract to convey a specific object even before it is acquired will make the contractor a trustee as soon as he gets title to the thing. See the opinion of Mr. Justice Holmes in *Barnes v. Alexander*, 232 U.S. 117, 58 L.ed. 530, 34 S.Ct. 276, affirming *Barnes v. Shattuck*, 13 Ariz. 338, 114 Pac. 952, in which the promise of one attorney to pay another attorney one-third of a fee to be received by the former was held to create a lien on such fee in

favor of the latter. In *Barnes v. Shattuck* (1911), 13 Ariz. 338, 343, 114 Pac. 952, 954, the Arizona Supreme Court stated:

> "To constitute an equitable assignment good as between the assignor and assignee, it is not essential that the debt should have been earned or the fund be *in esse* at the time of the assignment, or that notice be given the present or future holder of the fund. The intent of the parties to create the lien being apparent, it is sufficient that there be a reasonable expectancy that the debt will be fully earned and the fund come into existence."

Likewise, in *Allen v. Hamman Lumber Co.* (1934), 44 Ariz. 145, 148, 34 P.2d 397, 399, the Arizona court said:

> "* * * The general rule of law is that the true test of an equitable assignment is whether the debtor would be justified in paying the debt to the person claiming to be the assignee, and that an assignment may be by parol or in writing, or partly in writing and partly oral. Any language, however informal, which shows an intention of an owner of a chose in action to transfer it so that it will be the property of the transferee will amount to an equitable assignment if sustained by a sufficient consideration. In 5 C.J. 927, it is said: 'An order drawn on a debtor, payable out of a debt or fund in or coming into his hands, will operate as an assignment of either the whole or part of such debt or fund, depending on whether the order is for the whole or for a part thereof, if the order is accepted by the drawee * * *.'"

Under the rule of the *Allen* case, the true test of an equitable assignment is whether the debtor would be justified in paying the debt to the person claiming to be the assignee. Certainly under the terms of the letter agreement of May 8, 1963 (Joint Exhibit 32), and the undisputed testimony that

Martin performed under the letter agreement and remained unpaid, City would have been justified in delivering the improvement district bonds to Martin, rather than Construction.

The trial court in enforcing the agreement by Construction in Joint Exhibit 32 to assign the improvement district bonds, and concluding that a lien was created thereby, applied the fundamental rule that equity treats as done that which should have been done. *Phoenix Title and Trust Co. v. Alamos Land and Irrigation Co.* (1922), 24 Ariz. 499, 211 Pac. 570. The conclusion that Martin's rights to the bond are superior to those of the Trustee must be affirmed.

Respectfully submitted.

CHANDLER, TULLAR, UDALL & RICHMOND
By JAMES L. RICHMOND
Attorneys for Appellees
Pacific National Insurance
Company and Martin
Construction Company

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAMES L. RICHMOND

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Opening Brief on Cross-Appeal

The Prefatory Note, Jurisdictional Statement, and Statement of the Case in the Answering Brief of Appellees Pacific National Insurance Company and Martin Construction Company, *supra*, are adopted herein by this reference.

SPECIFICATION OF ERROR

The District Court erred in its conclusion that Martin's rights to the improvement district bonds were inferior to those of Bank as Construction's assignee, because Construction, never having paid Martin's claim for labor and materials, never perfected its right to receive the bonds, and because an unpaid subcontractor, like Martin, or a surety required by the terms of its obligation to pay such unpaid subcontractor, like Pacific, has a right to the extent of the

claim of the unpaid subcontractor in the undelivered contract proceeds superior to any right of the defaulting prime contractor or its assignee.

ARGUMENT

Martin, the unpaid subcontractor, and Pacific, surety on the labor and material bond, assert that their rights are coextensive on this cross-appeal, and superior to those of Bank. It is their position that Construction, never having paid Martin, breached its contract and never perfected its right to the improvement district bonds. Bank, as Construction's assignee, could acquire no greater rights than its assignor.

The Wilmot Improvement District Contract, at page 97 of Joint Exhibit 18, provides as follows:

> "The party of the first part (Construction Materials Co.) further agrees that it will do and perform said work . . . and that it will, within the time hereinafter fixed, turn the said work over to the said Superintendent of Streets, complete and ready for use *free and discharged of all claims and demands whatsoever, for or on account of any and all labor and materials used or furnished to be used in said improvements.*
>
> "And the said party of the second part (the Superintendent of Streets of the City of Tucson, as contracting agent for the improvement district) . . . promises and agrees that *upon the performance of the covenants aforesaid by the said party of the first part,* he will make and issue an assessment. . . ." etc. (Emphasis supplied).

It is evident from the foregoing that any right of the contractor to payment under the improvement district contract is on the express condition that it first perform its covenants, including its covenant that it will "turn the said

work over to the said Superintendent of Streets, complete and ready for use free and discharged of all claims and demands whatsoever, for or on account of any and all labor and materials used or furnished to be used in said improvements."

Furthermore, by the terms of the labor and material bond at page 99 of Joint Exhibit 18, Construction as principal binds itself, its heirs, successors and *assigns*, in the amount of $87,748.93 on the express condition that it "shall promptly make payment for all labor performed and services rendered and materials furnished in the prosecution of the work" provided for in the Wilmot contract.

City on September 6, 1963, received a letter written on behalf of Martin, reciting a claim of $68,754.42 for materials, labor and equipment furnished in connection with the Wilmot contract. Improvement district bonds in the sum of $57,383.64 were issued by City and delivered to the Clerk of the United States District Court subsequent to receipt of the letter by the City.

Under these facts Construction would only have become entitled to the improvement district bonds had it completed its job and paid its laborers and materialmen; City had a right to use the bonds to pay laborers and materialmen; Martin had a right to be paid out of the bonds, and surety upon payment of the laborers and materialmen would become entitled to the benefit of all these rights to the extent necessary to reimburse it. *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 9 L ed 2d 190, 83 S.Ct. 232 (1962).

The *Pearlman* opinion under the Miller Act held that the government contractor, having failed to pay laborers and materialmen in accordance with the contract terms, never acquired any right under the contract to retained funds; therefore, no property interest therein vested in the con-

tractor's trustee in bankruptcy. The surety had paid the unpaid laborers and materialmen at the time of adjudication in bankruptcy. The majority opinion held that the surety was entitled to the retained funds, apparently through subrogation to the rights of the laborers and materialmen whom it paid. The opinion cites and reaffirms *Prairie State Nat. Bank v. United States,* 164 U.S. 227, 41 L ed 412, 17 S. Ct. 142 (1896), and *Henningsen v. United States Fidelity & G. Co.,* 208 U.S. 404, 52 L ed 547, 28 S.Ct. 389 (1908), in their holdings that a surety who completes a government contract, or who pays laborers' and materialmen's claims upon the prime contractor's default, stands in the shoes of the government as to the funds retained for completion of the contract, including payment of such claims. In both the *Prairie Bank* case and the *Henningsen* case, the rights of the surety were held superior to those of a bank which, like Bank in this case, had been assigned the retained contract proceeds as security for funds advanced to the contractor. The cases upheld an equitable right of the surety through subrogation to the rights which the United States might have asserted against the retainage, and held that such equity arose in favor of the surety on execution of the contract of suretyship and thus was prior in date and paramount to that arising in favor of the bank at the time of the subsequent assignment.

In addition, Pacific's right that City use the improvement district bonds in satisfaction of the labor and materials claims for which Pacific was surety is an independent right and thus not dependent upon subrogation. *Hochevar v. Maryland Casualty Co.* (CCA 6, 1940), 114 F2d 948, 951.

Under the rule of *Pearlman,* and the cases which it reaffirms, neither Construction nor Bank as its assignee could acquire any right to the improvement district bonds until

Martin's claim for labor and materials had been paid, and Pacific is entitled to have the bonds applied toward payment of the Martin claim. Thus, the trial court's conclusion of law that Martin's interest in the improvement district bonds is inferior to that of Bank was in error. The judgment of May 26, 1965, insofar as it provides for the delivery to Bank of improvement district bonds in the sum of $25,126.69, together with interest thereon at the rate of 6% per annum from December 12, 1963, until the date of judgment, should be reversed, and judgment entered in favor of Martin for the improvement district bonds in said amount.

Respectfully submitted,

CHANDLER, TULLAR, UDALL & RICHMOND

By JAMES L. RICHMOND

Attorneys for Cross-Appellants Martin Construction Company and Pacific National Insurance Company

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAMES L. RICHMOND